days after he is first apprised of such action by the Director of International Operations.

[T.D. 6764, 29 FR 14628, Oct. 27, 1964; 29 FR 15204, Nov. 11, 1964, as amended by T.D. 6787, 29 FR 18502, Dec. 29, 1964; T.D. 6995, 34 FR 832, Jan. 18, 1969; T.D. 7221, 37 FR 24747, Nov. 21, 1972; T.D. 7322, 39 FR 30931, Aug. 27, 1974; T.D. 7545, 43 FR 19652, May 8, 1978; T.D. 7862, 47 FR 56491, Dec. 17, 1982; T.D. 7893, 48 FR 22510, May 19, 1983; T.D. 9260, 71 FR 24540, Apr. 25, 2006; T.D. 9260, 71 FR 77265, Dec. 26, 2006]

§ 1.964–1T Determination of the earnings and profits of a foreign corporation (temporary).

(a) through (c)(1)(iv) [Reserved]. For further guidance, see §1.964–1(a) through (c)(1)(iv).

(v) *Taxable years.* The period for computation of taxable income and earnings and profits known as the taxable year shall reflect the provisions of section 441 and the regulations thereunder.

(2) *Adoption or change of method or taxable year.* For the first taxable year of a foreign corporation beginning after April 25, 2006, in which such foreign corporation first qualifies as a controlled foreign corporation (as defined in section 957 or 953) or a noncontrolled section 902 corporation (as defined in section 904(d)(2)(E)), any method of accounting or taxable year allowable under this section may be adopted, and any election allowable under this section may be made, by such foreign corporation or on its behalf notwithstanding that, in previous years, its books or financial statements were prepared on a different basis, and notwithstanding that such election is required by the Internal Revenue Code or regulations to be made in a prior taxable year. Any allowable methods adopted or elections made shall be reflected in the computation of the foreign corporation's earnings and profits for such taxable year, prior taxable years, and (unless the Commissioner consents to a change) subsequent taxable years. However, see section 898 for the rules regarding the taxable year of a specified foreign corporation as defined in section 898(b). Any allowable method of accounting or election that relates to events that first arise in a subsequent taxable year may be adopted or made by or on behalf of the foreign corporation for such year. See paragraph (a)(3) of this section for the manner in which a method of accounting or a taxable year may be adopted or changed on behalf of the foreign corporation. See paragraph (c)(4) and (g)(3) of this section for applicable rules if the amount of the foreign corporation's earnings and profits became significant for United States tax purposes before a method of accounting or taxable year was adopted by the foreign corporation or on its behalf in accordance with the rules of paragraph (c)(3) of this section. See paragraphs (c)(6) and (g)(2) of this section for special rules postponing the time for taking action by or on behalf of a foreign corporation until the amount of its earnings and profits becomes significant for U.S. tax purposes.

(3) *Action on behalf of corporation*—(i) *In general.* An election shall be deemed made, or an adoption or change in method of accounting or taxable year deemed effectuated, on behalf of the foreign corporation only if its controlling domestic shareholders (as defined in paragraph (c)(5) of this section)—

(A) Satisfy for such corporation any requirements imposed by the Internal Revenue Code or applicable regulations with respect to such election or such adoption or change in method or taxable year (including the provisions of sections 442 and 446 and the regulations thereunder, as well as any operative provisions), such as the filing of forms, the execution of consents, securing the permission of the Commissioner, or maintaining books and records in a particular manner. For purposes of this paragraph (c)(3)(i)(A), the books of the foreign corporation shall be considered to be maintained in a particular manner if the controlling domestic shareholders or the foreign corporation regularly keep the records and accounts required by section 964(c) and the regulations thereunder in that manner;

(B) File the statement described in paragraph (c)(3)(ii) of this section, at the time and in the manner prescribed therein; and

(C) Provide the written notice required by paragraph (c)(3)(iii) of this section at the time and in the manner prescribed therein.

(ii) *Statement required to be filed with a tax return.* The statement required by this paragraph (c)(3)(ii) shall set forth the name, country of organization, and U.S. employer identification number (if applicable) of the foreign corporation, the name, address, stock interests, and U.S. employer identification number of each controlling domestic shareholder (or, if applicable, the shareholder's common parent) approving the action, and the names, addresses, U.S. employer identification numbers, and stock interests of all other domestic shareholders notified of the action taken. Such statement shall describe the nature of the action taken on behalf of the foreign corporation and the taxable year for which made, and identify a designated shareholder who retains a jointly executed consent confirming that such action has been approved by all of the controlling domestic shareholders and containing the signature of a principal officer of each such shareholder (or its common parent). Each controlling domestic shareholder shall file the statement with its own tax return (or information return, if applicable) for its taxable year with or within which ends the taxable year of the foreign corporation for which the election is made or for which the method of accounting or taxable year is adopted or changed.

(iii) *Notice*. On or before the filing date described in paragraph (c)(3)(ii) of this section, the controlling domestic shareholders shall provide written notice of the election made or the adoption or change of method or taxable year effected to all other persons known by them to be domestic shareholders who own (within the meaning of section 958(a)) stock of the foreign corporation. Such notice shall set forth the name, country of organization and U.S. employer identification number (if applicable) of the foreign corporation, and the names, addresses, and stock interests of the controlling domestic shareholders. Such notice shall describe the nature of the action taken on behalf of the foreign corporation and the taxable year for which made, and identify a designated shareholder who retains a jointly executed consent confirming that such action has been approved by all of the controlling domestic shareholders and containing the signature of a principal officer of each such shareholder (or its common parent). However, the failure of the controlling domestic shareholders to provide such notice to a person required to be notified shall not invalidate the election made or the adoption or change of method or taxable year effected.

(4) *Effect of action or inaction by controlling domestic shareholders*. Any action taken by the controlling domestic shareholders on behalf of the foreign corporation pursuant to paragraph (c)(3) of this section shall be reflected in the computation of the earnings and profits of such corporation under this section to the extent that it bears upon the tax liability of all domestic shareholders of the foreign corporation. See §1.964–1T(g)(5). In the event that action by or on behalf of the foreign corporation is not undertaken by the time specified in paragraph (c)(6) of this section and such failure is shown to the satisfaction of the Commissioner to be due to reasonable cause, such action may be undertaken during any period of at least 30 days occurring after such showing is made which the Commissioner may specify as appropriate for this purpose. The principles of §1.964–1T(g)(3) and (g)(4) shall apply in determining the effect of a failure of the controlling domestic shareholders to take action on behalf of the foreign corporation pursuant to paragraph (c)(3) of this section. Accordingly, if the earnings and profits of a noncontrolled section 902 corporation became significant for United States income tax purposes in a taxable year beginning on or before April 25, 2006, the corporation's earnings and profits shall be computed as if no elections had been made and any permissible accounting methods not requiring an election and reflected in the books of account regularly maintained by the foreign corporation for purposes of accounting to its shareholders had been adopted. Any change in accounting method may be made by or on behalf of the foreign corporation only with the Commissioner's consent.

(5) *Controlling domestic shareholders*—(i) *Controlled foreign corporations*. For purposes of this paragraph, the controlling domestic shareholders of a controlled foreign corporation shall be its controlling United States shareholders.

The controlling United States shareholders of a controlled foreign corporation shall be those United States shareholders (as defined in section 951(b) or 953(c)) who, in the aggregate, own (within the meaning of section 958(a)) more than 50 percent of the total combined voting power of all classes of the stock of such foreign corporation entitled to vote and who undertake to act on its behalf. In the event that the United States shareholders of the controlled foreign corporation do not, in the aggregate, own (within the meaning of section 958(a)) more than 50 percent of the total combined voting power of all classes of the stock of such foreign corporation entitled to vote, the controlling United States shareholders of the controlled foreign corporation shall be all those United States shareholders who own (within the meaning of section 958(a)) stock of such corporation.

(ii) *Noncontrolled section 902 corporations*. For purposes of this paragraph, the controlling domestic shareholders of a noncontrolled section 902 corporation that is not a controlled foreign corporation shall be its majority domestic corporate shareholders. The majority domestic corporate shareholders of a noncontrolled section 902 corporation shall be those domestic corporations that meet the ownership requirements of section 902(a) with respect to the noncontrolled section 902 corporation (or to a first-tier foreign corporation that is a member of the same qualified group as defined in section 902(b)(2) as the noncontrolled section 902 corporation) that, in the aggregate, own directly or indirectly more than 50 percent of the combined voting power of all of the voting stock of the noncontrolled section 902 corporation that is owned directly or indirectly by all domestic corporations that meet the ownership requirements of section 902(a) with respect to the noncontrolled section 902 corporation (or a relevant first-tier foreign corporation).

(6) *Action not required until significant*. Notwithstanding any other provision of this paragraph, action by or on behalf of a foreign corporation (other than a foreign corporation subject to tax under section 882) to make an election or to adopt a taxable year or method of accounting shall not be required until the due date (including extensions) of the return for a controlling domestic shareholder's first taxable year with or within which ends the foreign corporation's first taxable year in which the computation of its earnings and profits is significant for United States tax purposes with respect to its controlling domestic shareholders (as defined in §1.964–1T(c)(5)). The filing of the information return required by section 6038 shall not itself constitute a significant event. For taxable years beginning on or after April 25, 2006, events that cause a foreign corporation's earnings and profits to have United States tax significance include, without limitation,

(i) A distribution from the foreign corporation to its shareholders with respect to their stock;

(ii) An amount is includible in gross income with respect to such corporation under section 951(a);

(iii) An amount is excluded from subpart F income of the foreign corporation or another foreign corporation by reason of section 952(c);

(iv) Any event making the foreign corporation subject to tax under section 882;

(v) The use by the foreign corporation's controlling domestic shareholders of the tax book value (or alternative tax book value) method of allocating interest expense under section 864(e)(4); or

(vi) A sale or exchange of the foreign corporation's stock of the controlling domestic shareholders that results in the recharacterization of gain under section 1248.

(c)(7) and (8) [Reserved]. For further guidance, see §1.964–1(c)(7) and (c)(8) and §1.964–1T(g)(6).

(d)–(f) [Reserved]

(g)(1) *Earnings and profits computed in functional currency*—(i) *Rule*. For taxable years of a controlled foreign corporation (within the meaning of section 957) beginning after December 31, 1986, earnings and profits shall be computed in the controlled foreign corporation's functional currency (determined under section 985 and the regulations thereunder) in accordance with §1.964–1 as modified by this paragraph (g). Accordingly, §1.964–1 (d), (e), and (f) and (to the extent inconsistent with this paragraph (g)) §1.964–1(c) do not apply for taxable years of a controlled foreign corporation beginning after December 31, 1986. For purposes of this section, the term ''earnings and profits'' includes a deficit in earnings and profits.

(ii) *Cross reference.* In the case of a controlled foreign corporation with a functional currency other than the United States dollar (dollar), see sections 986(b) and 989(b) for rules regarding the time and manner of translating distributions or inclusions of the controlled foreign corporation's earnings and profits into dollars.

(2) *Election required when first significant.* Tax accounting methods or elections may be adopted or made by, or on behalf of, a controlled foreign corporation in the manner prescribed by the Code and regulations no later than 180 days after the close of the first taxable year of the controlled foreign corporation in which the computation of its earnings and profits is significant for United States income tax purposes with respect to its controlling United States shareholders (as defined in §1.964–1(c)(5)). For taxable years of a controlled foreign corporation beginning before January 1, 1989, only the events listed in §1.964–1(c)(6) are considered to cause a controlled foreign corporation's earnings and profits to have United States tax significance. For taxable years of a controlled foreign corporation beginning after December 31, 1988, events that cause a controlled foreign corporation's earnings and profits to have United States tax significance include, without limitation—

(i) The events listed in §1.964–1(c)(6),

(ii) A distribution from the controlled foreign corporation to its shareholders with respect to their stock,

(iii) Any event making the controlled foreign corporation subject to tax under section 882,

(iv) An election by the controlled foreign corporation's controlling United States shareholders to use the tax book value method of allocating interest expense under section 864(e)(4), and

(v) A sale or exchange of the controlled foreign corporation's stock by the controlling United States shareholders.

The filing of the information return required by section 6038 shall not itself constitute a significant event.

(3) *Effect of failure to make required election.* If an accounting method or election is not timely adopted or made by, or on behalf of, a controlled foreign corporation, and such failure is not shown to the satisfaction of the Commissioner to be due to reasonable cause under §1.964–1(c)(6), earnings and profits shall be computed in accordance with this section. Such computation shall be made as if no elections had been made and any permissible accounting methods not requiring an election and reflected in the books of account regularly maintained by the controlled foreign corporation for the purpose of accounting to its shareholders had been adopted. Thereafter, any change in a particular accounting method or methods may be made by, or on behalf of, the controlled foreign corporation only with the Commission's consent.

(4) *Computation of earnings and profits by a minority shareholder prior to majority election or significant event.* A minority United States shareholder (as defined in section 951(b)) of a controlled foreign corporation may be required to compute a controlled foreign corporation's earnings and profits before the controlled foreign corporation or its controlling United States shareholders make, or are required under this section to make, an election or adopt a method of accounting for United States tax purposes. In such a case, the minority United States shareholder must compute earnings and profits in accordance with this section. Such computation shall be made as if no elections had been made and any permissible accounting methods not requiring an election and reflected in the books of account regularly maintained by the controlled foreign corporation for the purpose of accounting to its shareholders had been adopted. However, a later, properly filed, and timely election or adoption of method by, or on behalf of, the controlled foreign corporation shall not be treated as a change in accounting method.

(5) *Binding effect.* For taxable years beginning after December 31, 1986, except as otherwise provided in the Code

or regulations, earnings and profits of a controlled foreign corporation shall be computed consistently under the rules of sections 964(a) and 986(b) for all federal income tax purposes. An election or adoption of a method of accounting for United States tax purposes by a controlled foreign corporation, or on its behalf pursuant to §1.964–1(c) or any other provision of the regulations (*e.g.*, §1.985–2(c)(3)), shall bind both the controlled foreign corporation and its United States shareholders as to the computation of the controlled foreign corporation's earnings and profits under section 964(a) for the year of the election or adoption and in subsequent taxable years unless the Commissioner consents to a change. The preceding sentence shall apply regardless of—

(i) Whether the election or adoption of a method of accounting was made in a pre-1987 or a post-1986 taxable year;

(ii) Whether the controlled foreign corporation was a controlled foreign corporation at the time of the election or adoption of method;

(iii) When ownership was acquired; or

(iv) Whether the United States shareholder received the written notice required by §1.964–1(c)(3).

Adjustments to the appropriate separate category (as defined in §1.904–5(a)(1)) of earnings and profits and income of the controlled foreign corporation shall be required using the principles of section 481 to prevent any duplication or omission of amounts attributable to previous years that would otherwise result from any such election or adoption.

(6) *Examples*. The following examples illustrate the rules of this section.

Example 1: (i) *P*, a calendar year domestic corporation, owns all of the outstanding stock of *FX*, a calendar year controlled foreign corporation. None of the significant events specified in §1.964–1(c)(6) or this section has occurred. In addition, neither *P* nor *FX* has ever made or adopted, or been required to make or adopt, an election or method of accounting for United States tax purposes with respect to *FX*. On June 1, 1990, *FX* makes a distribution to *P*. *FX* does not act to make any election or adopt a method of accounting for United States tax purposes.

(ii) *P* must compute *FX*'s earnings and profits in order to determine if any portion of the distribution is taxable as a dividend and to determine *P*'s foreign tax credit on such portion under section 902. *P* must satisfy the requirements of §1.964–1(c)(3) and file the written statement and notice described therein within 180 days after the close of *FX*'s 1990 taxable year in order to make an election or to adopt a method of accounting on behalf of *FX*. Any such election or adoption will govern the computation of earnings and profits of *FX* for all federal income tax purposes (including, *e.g.*, the determination of foreign tax credits on subpart F inclusions) in 1990 and subsequent taxable years unless the Commissioner consents to a change.

(iii) If *P* fails to satisfy the regulatory requirements in a timely manner and such failure is not shown to the satisfaction of the Commissioner to be due to reasonable cause, the earnings and profits of *FX* shall be computed as if no elections were made and any permissible methods of accounting not requiring an election and reflected in its books were adopted. Any subsequent attempt by *FX* or *P* to change an accounting method shall be effective only if the Commissioner consents to the change.

Example 2: (i) The facts are the same as in *Example 1*, except that *P* elects to allocate its interest expense under section 864(e)(4) for its 1989 taxable year under the tax book value method of §1.861–12T(c) of the Temporary Income Tax Regulations.

(ii) *P* must compute the earnings and profits of *FX* in order to determine the adjustment to *P*'s basis in the stock of *FX* for *P*'s 1989 taxable year. *P* must satisfy the requirements of §1.964–1(c)(3) and file the written statement and notice described therein within 180 days after the close of *FX*'s 1989 taxable year in order to make an election or to adopt a method of accounting on behalf of *FX*. Any such election or adoption will govern the computation of *FX*'s earnings and profits in 1989 and subsequent taxable years for all federal income tax purposes (including, *e.g.*, the characterization of the June 1, 1990 distribution and the determination of *P*'s foreign tax credit, if any, with respect thereto) unless the Commissioner consents to a change.

(iii) If *P* fails to satisfy the regulatory requirements in a timely manner and such failure is not shown to the satisfaction of the Commissioner to be due to reasonable cause, the earnings and profits of *FX* shall be computed as if no elections were made and any permissible methods of accounting not requiring an election and reflected in its books were adopted. Any subsequent attempt by *FX* or *P* to change an accounting method shall be effective only if the Commissioner consents to the change.

Example 3: (i) The facts are the same as in *Example 2*, except that *P* elects to allocate its interest expense under section 864(e)(4) for its 1988 taxable year under the tax book value method of §1.861–12T (c) of the Temporary Income Tax Regulations.

(ii) *P* must compute the earnings and profits of *FX* in order to determine the adjustment to *P*'s basis in the stock of *FX* for *P*'s 1988 taxable year. *P* must satisfy the requirements of §1.964–1(c)(3) and file the written statement and notice described therein within 180 days after the close of *FX*'s 1988 taxable year in order to make an election or to adopt a method of accounting on behalf of *FX*. Any such election or adoption will govern the computation of *FX*'s earnings and profits in 1988 and subsequent taxable years for all federal income tax purposes (including, *e.g.*, *P*'s basis adjustment for purposes of section 864(e)(4) in 1989 and the characterization of the June 1, 1990 distribution and the determination of *P*'s foreign tax credit, if any, with respect thereto) unless the Commissioner consents to a change.

(iii) If *P* fails to satisfy the regulatory requirements in a timely manner and such failure is not shown to the satisfaction of the Commissioner to be due to reasonable cause, the earnings and profits of *FX* for 1988 shall be computed as if no elections were made and any permissible methods of accounting not requiring an election and reflected in its books were adopted. However, a properly filed, timely election or adoption of method by, or on behalf of, *FX* with respect to its 1989 taxable year, when *P*'s basis adjustment for purposes of section 864(e)(4) first constitutes a significant event, shall not be treated as a change in accounting method. No recomputation of *P*'s basis adjustment for 1988 shall be required by reason of any such election or adoption of method with respect to *FX*'s 1989 taxable year, but prospective adjustments to *FX*'s earnings and profits and income shall be made to the extent required by §1.964–1T(g)(5).

Example 4: (i) The facts are the same as in *Example 3*, except that *FX* had subpart F income taxable to *P* in 1986, and *P* computed *FX*'s earnings and profits for purposes of determining the amount of the inclusion and the foreign taxes deemed paid by *P* in 1986 under section 960 pursuant to §1.964–1 (a) through (e).

(ii) Any election made or method of accounting adopted on behalf of *FX* by *P* pursuant to §1.964–1(c) in 1986 is binding on *P* and *FX* for purposes of computing *FX*'s earnings and profits in 1986 and subsequent taxable years. Thus, in determining *P*'s basis adjustment for purposes of section 864(e)(4) in 1988 and 1989 and its deemed-paid credit with respect to the 1990 dividend, *FX*'s earnings and profits must be computed consistently with the method used by *P* with regard to the 1986 subpart F inclusion. (However, §1.964–1 (d), (e), and (f) do not apply in computing *FX*'s earnings and profits in post-1986 taxable years.)

Example 5: (i) The facts are the same as in *Example 4*, except that *FX* made a dividend distribution to *P* on June 1, 1985, and *P* computed *FX*'s earnings and profits for purposes of computing the foreign taxes deemed paid by *P* in 1985 under section 902 with respect to the distribution under §1.964–1 exclusive of paragraphs (d), (e), and (f) pursuant to a timely election under §1.902–1(g)(1).

(ii) Any election made or method of accounting adopted on behalf of *FX* by *P* pursuant to §1.964–1(c) in 1985 is binding on *P* and *FX* for purposes of computing *FX*'s earnings and profits in 1985 and subsequent taxable years. Thus, in determining *P*'s basis adjustment for purposes of section 864(e)(4) in 1988 and 1989 and its deemed-paid credit with respect to the 1986 subpart F inclusion and the 1990 dividend, *FX*'s earnings and profits must be computed consistently with the method used by *P* with regard to the 1985 dividend. If, rather than choosing under §1.902–1(g)(1) to use the section 964 rules, *P* computed *FX*'s earnings and profits for purposes of section 902 in 1985 in all respects as if *FX* were a domestic corporation, then *P* would have been free to make elections or adopt a method of accounting on behalf of *FX* under §1.964–1(c) with respect to the subpart F inclusion in 1986. Any such election or adoption would be binding on *P* and *FX* as to the computation of *FX*'s earnings and profits in 1986 and subsequent taxable years.

[T.D. 8283, 55 FR 2516, Jan. 25, 1990; 55 FR 7711, Mar. 5, 1990, as amended by T.D. 9260, 71 FR 24540, Apr. 25, 2006; T.D. 9260, 71 FR 77266, Dec. 26, 2006]

§ 1.964–2 Treatment of blocked earnings and profits.

(a) *General rule.* If, in accordance with paragraph (d) of this section, it is established to the satisfaction of the district director that any amount of the earnings and profits of a controlled foreign corporation for the taxable year (determined under §1.964–1) was subject to a currency or other restriction or limitation imposed under the laws of any foreign country (within the meaning of paragraph (b) of this section) on its distribution to United States shareholders who own (within the meaning of section 958(a)) stock of such corporation, such amount shall not be included in earnings and profits for purposes of sections 952, 955 (as in effect both before and after the enactment of the Tax Reduction Act of 1975), and 956 for such taxable year. For rules governing the treatment of amounts with respect to which such restriction